IRS Collection Update

Bar Association of San Francisco
Taxation Section
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OUTLINE

A. Taxpayer with Tax Debt - Possible Options

1) Full pay
2) Installment agreement
3) Offer in Compromise
4) Bankruptcy

1. Full Pay

2. Installment Agreement

a) *The Basics*

i) Overview - Arrangement with IRS to pay tax liability over a period of time. Must be in tax filing compliance and stay in future compliance to obtain/maintain installment agreement (IA).

ii) Partial Pay Installment Agreement - If the IRS determines the amount a taxpayer (Taxpayer) can pay on an IA will not fully pay off the tax liability before the collection statute expiration date (CSED), it may set up a "partial pay installment agreement" (PPAI).

b) *What's New*

IRS Fresh Start Initiative (FSI) introduced an increased threshold for a streamlined IA to $50,000 from $25,000 for individuals. The limit for businesses is $25,000 on a streamlined IA. *A streamlined IA does not require financial information to be submitted to the IRS* and can stretch out payments up to 72 months (increased from 60 months).

c) *Hot Tip:*

A Taxpayer may pay down a balance to just under $50,000 and pursue a streamlined IA to avoid the (expensive and time-consuming) need to provide financial forms and supporting documents to the IRS.

3. Offers in Compromise

a) *The Basics*

i) Overview - Permits Taxpayers to settle their tax debt for less than the full amount due in certain circumstances due to:

a. inability to fully pay (doubt as to collectability),
b. doubt as to liability, or
c. the compromise serves the interest of effective tax administration.

ii) Key number for offers based on doubt as to collectability: Reasonable Collection Potential (RCP). The IRS considers all assets in the RCP calculation including equity in an owned residence and retirement accounts. On the income side, the RCP is based on the Taxpayer's monthly gross income less expenses, but only some expenses are allowed and only up to a certain IRS-prescribed amounts.

b) *What's New*

i) A significant change in the OIC program is the change on the net future income calculation. There are two payment options with OIC - selected at the start:

a. Lump-sum: 20% of offered amount included with the submission of the OIC; plus, the rest of offered amount must be paid within five (5) months of acceptance.

b. Periodic-payment: no 20% down payment required but must start making proposed monthly payments right away and continue throughout period OIC is being considered/processed - and beyond if accepted.

Previously, the RCP used 48, 60 or even more months of the determined future monthly net income. Thus, the monthly net income was determined and then multiplied by 48, 60 or more in determining the income portion of the RCP. *Now, only 12 months of net income is used if a lump sum offer is made and 24 months if a periodic payment offer is made*.

EXAMPLE

Reasonable Collection Potential (RCP) Calculation:

Net Equity in Assets	=	\$12,000
Monthly Net Income	=	\$800
RCP on Lump-Sum OIC	=	\$21,600 (\$800 times 12 plus \$12,000)
RCP on Periodic Payment OIC	=	\$31,200 (\$800 times 24 plus \$12,000)

Note - In determining if a Taxpayer can fully pay his tax liability and, thus, is ineligible for an OIC, the IRS, however, still uses the higher number of months (such as the number of months left on the CSED). Thus, the RCP is calculated for two reasons: first, to determine if Taxpayer can fully pay within CSED and, if not, second, to determine minimum acceptable offer amount. It is only the latter step to which this change - to 12 or 24 months - applies.

ii) Forms 656/433 - Updated on January 2014. The family of Forms 433, used to profile a Taxpayer's financial circumstances, has expanded and includes some Taxpayer-friendly calculation features. See attached Forms 433(OIC) and 656.

iii) The OIC application fee increased from \$150 to \$186 (still may be waived for low-income taxpayers)

iv) IRS now has a pre-qualifier tool on its website that may help Taxpayers determine if OIC is an option for them.

v) Dissipated assets - As part of the Fast Start Initiative, there are fewer situations when dissipated assets will be included in the RCP.

vi) OICs based on Effective Tax Administration – A possible solution for clients with serious health issues and/or medical costs – but enough assets to full-pay the tax liability.

c) *Hot Tips*

i) Designating OIC Payments to specific tax periods - The Form 656 allows Taxpayers to designate payments made with an OIC (for example, the 20% down payment, pending offer payments).

ii) Include extra costs for older vehicles

iii) If at all possible, select the lump-sum offer option over periodic payments. Reduce your client's total amount paid and reduce risk of default.

iv) Expenses in Future Income - Before submitting the OIC, identify every possible allowable expense which the Taxpayer can substantiate, especially those not limited by application of the IRS national expense standards.

4. Bankruptcy

Some tax debt is dischargeable in bankruptcy. In particular circumstances, bankruptcy may be preferable to an OIC.

B. Liens and Levies

a) *The Basics*

Liens attach as a matter of law upon assessment of a tax liability. However, liens are now being recorded in fewer situations. Levies remain one of the Service's most motivating collection tools.

b) *What's New*

i) The threshold when a notice of federal tax lien will be filed increased from $5,000 to $10,000 in total amount outstanding.

ii) The IRS generally will withdraw filed Federal Tax Liens if the tax liability is under $25,000 and the Taxpayer enters into a direct debit Installment Agreement for the balance.

iii) Requests to discharge property from a federal tax lien now require processing time of 45 to 60 days from the date the request is assigned to an IRS representative.

C . First Time Penalty Relief

a) *The (little known) Basics*

The IRS generally will generally abate a penalty for failure to pay tax or failure to file a return for one period if the Taxpayer had no other penalties during the prior three years.

b) *Hot Tip*

Ask for the abatement if the Taxpayer qualifies. It is rare for the IRS to offer the abatement.

D. Voluntary Classification Settlement Program – Worker Classification Issues

a) *The Basics*

Companies functioning with independent contractors face inquiries regarding the proper classification of the workers instigated by the IRS and the workers themselves. The Voluntary Classification Settlement Program (VCSP) was developed by the IRS to allow companies to voluntarily reclassify their independent contractor workers as employees for future tax periods for employment tax purposes.

b) *What's New*

i) VCSP offers a simple, relatively low cost means to reclassify workers as employees. Participating companies submit a two-page form (IRS Form 8952), specifying the preferred date of conversion (at least sixty days prior to conversion).

ii) No payment is required with the VCSP application.

iii) No employment tax audit with respect to the worker classification of workers for prior years…no liability for penalties…no interest.

iv) The VCSP payment is highly favorable to the taxpayer company.

a. Ten percent of the amount of employment taxes calculated under the reduced rates of IRC section 3509(a),

b. For compensation paid for the most recent year,

c. For the workers being reclassified.

d. High level example: Company wishes to reclassify workers during 2013. Company paid workers $1,500,000 during 2012 (the most recent year). Under IRC section 3509(a), the applicable employment taxes for $1,500,000 in wages would be $154,200. Under VCSP, the company's payment would be $15,420, with no added penalties or interest. And, certainty of no audit for employment tax issues for the prior years.

v) Eligible participants include:

a. Companies with workers consistently treated as independent contractors or other non-employees who will be converted to employee status.

b. Companies must have filed Forms 1099 for the workers for the previous three years (or fewer years beginning when the company began operating with non-employees).

c. Must <u>not</u> be under audit currently by the IRS for employment tax issues. Companies undergoing an SS-8/Worker Classification review may apply to participate.

d. Must <u>not</u> be under audit by the Department of Labor or any state agency regarding the classification of workers. (However, if the company was audited and is complying with the determination, the company may apply to participate in the VCSP.)

c) *Hot Tips*

The Voluntary Classification Settlement Program may be the Service's best deal for taxpayer companies. The program combines simple application procedures at highly favorable tax rates payable for only one tax year with the certainty of being free from the threat of worker reclassification or employment tax audit for the reclassified workers.

Not all workers must be reclassified.

The VCSP unit is clandestine. Not even IRS Practitioner Hotline representatives have telephone access to the unit (based in Ogden). Apply and the unit will contact you.

E. Potpourri

- New fax numbers for submitting Forms 2848. For Ogden (CAF): 855-214-7522.
- Transcript access via the Practitioner's Hotline is more limited. The taxpayer must have an active issue in controversy.
- IRS e-Services are valuable time-savers (including for requesting transcripts), available to non-return preparers.